

VZCZCXR00967

RR RUEHCN RUEHDBU RUEHGH RUEHIK RUEHLN RUEHPOD RUEHSK RUEHSL RUEHVC
RUEHYG
DE RUEHVK #0098/01 2650300
ZNR UUUUU ZZH
R 220300Z SEP 09
FM AMCONSUL VLADIVOSTOK
TO RUEHC/SECSTATE WASHDC 1208
INFO RUEHXD/MOSCOW POLITICAL COLLECTIVE
RUCNCIS/CIS COLLECTIVE
RUEHZG/NATO EU COLLECTIVE
RUEHOO/CHINA POSTS COLLECTIVE
RUEHVK/AMCONSUL VLADIVOSTOK 1313

UNCLAS SECTION 01 OF 03 VLADIVOSTOK 000098

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [PGOV](#) [PREL](#) [MARR](#) [ECON](#) [ENRG](#) [EPET](#) [ETRD](#) [EIND](#) [ECIN](#)

EINV, RS, CH, JA

SUBJECT: SCENESETTER FOR VISIT OF EUR/RUS DIRECTOR KYLE SCOTT TO
VLADIVOSTOK

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¶1. (SBU) Summary: Consulate General Vladivostok warmly welcomes you to the Russian Far East (RFE). You are coming to a region rich in investment opportunities for U.S. firms, especially as Vladivostok builds new infrastructure in the run-up to APEC ¶2012. Such investment from U.S. firms would be welcome in this part of Russia, where anti-Americanism is less prevalent. Our military-to-military relations are recovering from the August 2008 conflict in Georgia, with a regular schedule of US Navy and Coast Guard port visits. While in the RFE, you will get an opportunity to discuss oil production on Sakhalin. You will also get a chance to examine Sino-Russian and Russo-Japanese relations away from the politics of the capitals, and see how individuals in the border regions interact. End summary.

Economic and Business Opportunities for U.S. Firms

¶12. (SBU) The vast potential for cooperation between the United States and Russia in the Russian Far East remains largely untapped. There are success stories and promising joint projects. Big name American companies like Boeing, John Deere, Freightliner, Exxon and Caterpillar are involved in the aviation, agriculture, transportation and energy sectors but there is still much to be done. Russia's fishing, timber, shipping, tourism and logistics industries would all benefit from partnerships with the United States. I am convinced American firms can benefit and do well here.

¶13. (SBU) The fact that Russia and the U.S. are neighbors in this part of the world is not fully exploited. That could change, however. Russia has decided to use APEC 2012 as a means of jump starting development in the region, and we hope there will be a expanded role for the U.S. in the energy and infrastructure projects that the government has in mind. From new bridges to atomic energy plants to wastewater treatment plants and a refurbished airport, the plans are ambitious and could have regional implications. China, Japan and Korea are keenly aware of the potential contracts and are aggressive in their investment strategies. U.S. firms remain more risk-averse, having had more invested in the region when Russia defaulted in ¶1998.

¶14. (SBU) Many American companies successfully operating in European Russia, however, are now looking to "Pacific Russia." Our message is that there are good partners here and that there are models for success. Corruption remains a problem. Russian officials who crusade against it find themselves up against powerful interests. So far, the powerful interests are winning that battle, but grassroots groups, including the indigenous

group "TIGER" are winning converts and making an impact on the political landscape.

Less Anti-Americanism

15. (SBU) The Consulate in Vladivostok now has a 17 year history of engagement, and the rich public diplomacy efforts have paid off. Youth orchestras, jazz bands, Broadway shows, joint baseball games, and student engagements have all produced a wellspring of goodwill for America that is useful when relations suffer.

16. (SBU) Anti-Americanism, even during low points in our relationship, is never as severe as in Moscow or St. Petersburg. American tourists are welcome and local people even in remote provinces still remember fondly Peace Corps volunteers who made a difference. The Lend-Lease program from World War II is not as well known, but we have capitalized on that legacy as well, placing a plaque on a locomotive that came from the U.S. to aid the Russian war effort, reminding Russians of our shared sacrifice and victory.

Military to Military Cooperation

17. (SBU) Military to military cooperation has always been robust at RFE ports. Thus far, in 2009 there were visits by two U.S. Navy ships and one Coast Guard ship, the U.S.S. SYCAMORE, which paid a port call on September 16-18. Celebrating Victory Day on May 9 has become a tradition for the U.S. and Russian navies. Seeing American sailors on the streets here, marching shoulder to shoulder with Russian sailors, is a powerful reminder of how successful we can be when we cooperate. The sailors engage in community relations events, from visiting orphanages to planting

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trees at the Veterans Home. More importantly, officers from both the U.S. and Russian navies have an opportunity to meet and discuss tactics and procedures for joint operations such as the fight against piracy. Additionally, U.S. Coast Guard cooperated with their Russian Border Guard colleagues to halt illegal drift net fishing that was seriously damaging Northern Pacific fish stocks.

Sakhalin and Oil Production

18. (SBU) Sakhalin is the site of the biggest U.S. investment in the Russia. Exxon is big enough to largely take care of its own interests, but the U.S. still plays a role and we are very pleased to have a Consular Agent on the island to monitor energy projects and provide American citizen services.

Sakhalin I

19. (SBU) ExxonMobil's main investment in Russia is in the Sakhalin I project, of which EM owns 30 percent and is the operator. Sakh I is the last major majority-foreign-owned project in Russia and one of only three Production Sharing Agreements (PSA, the others being Total's Kharyaga, which is relatively minor, and Sakhalin II, described below). Sakh I produces significant oil (peaked at 250,000 barrels per day, now down to about 160,000), and is a technological and economic success. However, it has been unable to realize its gas production potential due to an impasse with Gazprom. The likely best customer for Sakh I gas would be China. Gazprom maintains, however, that Sakh I cannot sell gas directly to China, as Gazprom is the sole authorized exporter of Russian gas (despite a specific exemption for PSAs in the law granting an export monopoly to Gazprom). The Sakh I consortium, whose partners include Sodeco (Japanese, 30 percent), ONGC (Indian, 20

percent), and Rosneft (20 percent), continues to negotiate this issue with Gazprom, while selling small volumes of gas in the region.

Sakhalin II

¶110. (SBU) The other major PSA in Russia, Sakhalin II (Sakhalin Energy Investment Company, SEIC), is primarily an LNG project, which was developed and built by a consortium led by Shell. In 2007, the consortium sold a majority stake in SEIC to Gazprom, after the project ran into trouble with environmental authorities. Shell now owns 27.5 percent of the project, Japan's Mitsui (12.5 percent) and Mitsubishi (10 percent). Sakh II shipped Russia's first cargo of LNG in March, 2009, and is touted as an example for future Russian participation in the LNG market. Gazprom's takeover of Sakh II was widely seen as an attack on foreign investment in Russia in the oil and gas sector. In March 2008, SEIC pulled its application for EX-IM financing when the request ran into delays. The project has been the subject of various inter-agency discussions in Washington.

Sino-Russian Relations

¶111. (SBU) Despite competition for geopolitical influence and access to Central Asian energy resources, Russia and China have built a pragmatic and cooperative bilateral relationship since resolving their border issues in 2004. A USD 25 billion loans-for-oil deal concluded earlier this year opens the way for an oil pipeline from Eastern Siberia to China that could be completed as early as 2010. A second leg of the Eastern Siberia-Pacific Ocean pipeline (ESPO) terminating at Nakhodka on the Pacific Coast would make Russian oil available to Japan, South Korea, and the world market. A proposed railway project linking Khabarovsk and Vladivostok would also involve Chinese investment and expertise. While China is one of Russia's largest bilateral trading partners, the structure of trade (primarily Russian raw materials for Chinese manufactured and consumer goods) highlights concerns of many Russian observers that Russia is merely a source of commodities for a more dynamic and technologically innovative Chinese economy.

¶112. (SBU) China has procured military and nuclear equipment from Russia in recent years, but purchases have declined as China develops its own military and nuclear industries and seeks better technology elsewhere. Russia and China share views on Iran, Afghanistan, and North Korea and have conducted joint

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military exercises as the two leading members of the Shanghai Cooperation Organization (SCO), and are both keen to restart the Six-Party negotiations and avoid any increase in tensions or military conflict on the Korean Peninsula.

¶113. (SBU) Fears of a Chinese demographic threat to the Russian Far East have subsided in recent years. Rather, there is a growing recognition in Siberia and the Russian Far East that Chinese labor, in addition to Chinese trade and investment, is vital to the region's economic development. China and other Asian countries, however, complained to Russia of unfair treatment when a large Asian market in Moscow was shut down recently and vendors' property seized.

Russo-Japanese Relations

¶114. (SBU) Japan's new government under Yukio Hatoyama is expected to make resolving the disputed sovereignty of the four Kuril Islands (Northern Territories) a top foreign policy priority, and Medvedev has signaled his willingness to discuss the issue. The dispute over the Kurils has not prevented Japan and Russia from working as cooperative partners in the Six-party

talks.

¶15. (SBU) With 90 percent of its oil imports from the Middle East, Japan sees economic and investment ties to Russia as a way to diversify its sources of fossil fuels. Japan is a major investor in the Sakhalin energy projects and LNG shipments to Japan from Sakhalin have just recently begun. While Japanese firms have been cautious about further investments, especially following Gazprom's maneuvers in 2007 to become majority shareholder in the Sakhalin-2 project, Japanese officials do not see such "business disputes" holding back further investment. Japanese companies are eyeing projects to develop Eastern Siberian oil fields whose production would flow to the Pacific via ESPO. Japanese firms, however, have shown less enthusiasm for participation in the investments proposed by Russia during PM Putin's May 2009 visit to Japan. During Putin's visit the two countries also announced completion of a civil nuclear agreement that paves the way for Russian uranium exports to Japan, where nuclear power generates a third of all electricity.

The agreement also opens the door for Japanese firms to provide cutting edge nuclear power technology to new Russian civilian reactors.

Comment

¶16. (SBU) Your visit will highlight the potential for increased environmental cooperation and showcase how well public diplomacy investments pay off. There is an air of expectation about Barack Obama's presidency and what it means for U.S.-Russian relations. Your give and take with political leaders, businessmen, and our staff is much anticipated and will help shape our message and I hope yours. I remain optimistic about U.S.-Russian relations and have already seen some great developments here, from direct flights to Alaska to direct cargo sailings to the port of Tacoma. The Consulate co-hosted the "Security in North East Asia Symposium" with the US Pacific Fleet, creating a network for dialogue on regional security issues. For tourists this is the start (or end) of the Trans Siberian railroad and it is a land that still has wild tigers and leopards. We have many challenges in our relationship, but progress continues and I am confident your visit will highlight the possibilities and attract more Americans to this fascinating part of the world.

ARMBRUSTER